

A Biweekly
Newsletter of
Federal Securities,
Corporate &
Banking Law
Developments

FED PROPOSES KEEPING CAPITAL TREATMENT FOR TRUST PREFERRED

In a proposed rule issued on May 6, 2004 by the Federal Reserve Board, both current and future issuances of trust preferred securities would continue to be treated as bank regulatory capital, up to 25% of Tier 1 Capital. However, other items would also be counted in reaching the 25% limit, reducing the use of trust preferred for this purpose. There would be a three-year transition period if the rule is adopted. The proposed rule can be found at <http://www.federalreserve.gov>. Comments are due by July 11, 2004.

The Fed's long-awaited proposal follows the SEC's recent endorsement of an accounting pronouncement that certain special-purpose subsidiaries should not be consolidated into the financial statements of a company. Trust preferred securities are currently counted as regulatory capital because they are issued by special purpose subsidiaries of bank holding companies and are consolidated into financial statements of the holding companies. Thus, the SEC's position had the potential of preventing any trust preferred from being considered as Tier 1 Capital.

In its proposed rule, the Fed argues that treating trust preferred as capital for regulatory purposes is appropriate even though it is not included as capital for purposes of generally accepted accounting principles (GAAP). According to the Fed, treating trust preferred as Tier 1 Capital is consistent with ensuring the safety and soundness of financial institutions, while excluding trust preferred from capital under GAAP serves the different purpose of ensuring transparency of financial statements.

The proposed rule would place quantitative and qualitative restrictions on the continued

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If you would like more information on these topics or have any questions, please e-mail us at CorporateNotes@KutakRock.com.

used of trust preferred securities for capital. The quantitative restrictions include:

- The 25% limit would be determined after reducing Tier 1 by any goodwill (current rules allow goodwill); and
- In determining the 25% limit, the bank holding company must not only count trust preferred securities and cumulative perpetual preferred stock (as under current rules) but also certain minority interests in consolidated subsidiaries.

The qualitative restrictions include that:

- No call feature would be required;
- The underlying subordinated note would need to conform, or be conformed by May 31, 2004, to the Fed's current subordinated debt policy statement; and
- No capital treatment would be allowed if a bank holding company purchased an interest in the same pool to which it issued its own trust preferred securities.

The new Fed rules would permit the continued use of trust preferred securities for Tier 1 Capital purposes, but only on a limited basis.

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■ CLOSELY-HELD COMPANIES CAN AVOID NEW NASDAQ AND NYSE INDEPENDENCE RULES

A public company with 50% or more of its voting power held by an individual, family or a group of shareholders that form a voting block, can designate itself as a "controlled" company and thereby avoid NYSE and NASDAQ director independence rules.

To do so, the company must disclose this election in its annual proxy statement. This allows the company to avoid some of the new corporate governance requirements otherwise applicable to public companies, such as having a majority of directors be "independent," and, for NYSE companies, having their nominating and compensation committees consist solely of independent directors. All companies are still required to have independent audit committees.

Despite this limited exception, many companies are still choosing to follow the new corporate governance rules as a matter of best practices and to hedge against potential stockholder lawsuits.

■ SEC PROPOSES NEW RULES FOR ASSET-BACKED SECURITIES

On May 3, the Securities and Exchange Commission proposed new and amended registration, disclosure, and reporting requirements for asset-backed securities. The proposals would update and clarify the registration requirements for asset-backed securities offerings, unify interpretive positions on asset-backed securities, and provide specific disclosure guidance and requirements. Comments on the proposed rules are due by July 12, 2004.

■ SEC REGISTRATION FEES TO BE RAISED

On April 30, the Securities and Exchange Commission announced new fee information

for registering stock or debt for purposes of public offerings, "going private" transactions, or mergers and acquisitions. The fee, as proposed, will actually decrease from \$126.70 to \$117.70 for each \$1.0 million of securities offered, effective the later of October 1, 2004 or 5 days after the SEC receives its appropriation from Congress.

■ FORMER RITE AID CEO GETS 10 YEARS IN PRISON

The 50 year-old former chief executive officer of Rite Aid Corp., pled guilty today to financial fraud in a deal that sends him to prison for ten years and costs him \$3.5 million in penalties and disgorgement. The fraud involved gross overstatement of the company's pre-tax income from 1998 to 2000 by \$2.3 billion, and net income by \$1.6 billion. This plea deal was approved after one calling for an eight year sentence was rejected by a U.S. District Court judge for being too lenient. **This plea deal serves as yet another reminder of the severe penalties that are being imposed for white-collar crimes.**

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